# In the Supreme Court of the United States

OCTOBER TERM, 1965

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No. 623

GEORGIA RAILROAD AND BANKING COMPANY,
PETITIONER

*v.*

UNITED STATES OF AMERICA

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*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT*

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## MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

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The instant case presents two discrete questions in the context of a highly unusual factual situation. Both questions were correctly resolved by the court below; they are of no general importance; and the instant decision does not conflict with any other appellate decision. There is no need for further review by this Court.

Petitioner owned substantial interests in two railroads. In 1881 it leased its stock in the two railroad

corporations for 99 years to an unrelated person. The lease required the lessees to pay petitioner a flat sum of $600,000 per year as rental; the lessees had possession of and were the record owners of the stock, had the right to vote it, and could collect and use the dividends thereon in any manner they chose. (348 F. 2d 278, 279-289.)

1. In general, the Code permits a corporation which is the beneficial owner of stock in another corporation to deduct on its tax return 85% of the dividend received, *i.e.*, the recipient corporation is, in effect, taxed on only 15% of the dividends which it receives. 1954 Code § 243; *Rupe Investment Corp.* v. *Commissioner*, 266 F. 2d 624 (C.A. 5); *Joseph L. O'Brien Co.* v. *Commissioner*, 301 F. 2d 813 (C.A. 3), certiorari denied, 371 U.S. 820.

The court of appeals held that petitioner was not, as a matter of economic substance, the beneficial owner of the leased securities, and was accordingly not entitled to any dividends—received deduction with respect to dividends paid to the lessees on the leased stock. The court noted, *inter alia*, that by entering into a 99-year lease petitioner "substituted a fixed annual income on its shareholdings for the normal risks of a business venture to which mere ownership of the shares would subject it," that the 99-year term "has afforded the lessees a substantial opportunity to manage and develop the two [leased] railroad companies," that the lessees really bear "the operating risks of the two enterprises," and that the lessees were free to use the dividends received on the stock for any pur-

pose they chose. On the basis of these undisputed facts the court below correctly concluded that "the lessor-taxpayer [petitioner] has, in substance, divested himself of beneficial ownership of the shares." (348 F. 2d at 283-284.)

The court of appeals was manifestly correct in holding clearly erroneous the district court's decision that the lessees, in effect, merely acted as a conduit by collecting the approximately $84,000 paid as dividends by the two leased corporations to the lessees during the tax period here in question and remitting that amount to petitioner.[1] The undisputed facts clearly demonstrate that the lessees had beneficial ownership of the stock during the term of the 99-year lease, that the fixed amount of $600,000 received annually by petitioner under the lease constituted rental income, and that no part of it was dividends.

The decision is correct and turns on the highly unusual facts presented. Seldom would a corporation enter into a long term lease of corporate stock owned by it. Therefore, whether a corporate lessor is entitled to the dividends received deduction in the instant circumstances is not of general importance.[2]

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[1] In fact, as the court below noted, until 1954 petitioner treated the entire $600,000 received annually as rental income and made no claim that it was entitled to the dividends received deduction. (348 F.2d at 284.)

[2] Nor does this Court's decision in *Wright* v. *Louisville & Nashville Railroad Co.*, 236 U.S. 687, conflict with the instant case. In *Louisville & Nashville Railroad Co.* this Court examined the provisions of the same 1881 lease here in question. Petitioner here, *i.e.*, the lessor, was, by virtue of special provisions in its charter, exempt from Georgia's ad valorem

2. In 1954, 73 years after execution of the 99-year lease, petitioner distributed its reversionary interest in the leased securities to its shareholders as a dividend in kind. Petitioner retained its interest under the lease, including the right to receive $600,000 rent annually. (348 F. 2d at 280-281, 286.) Petitioner had a basis of approximately $2,500,000 in the leased stocks. The district court held that, as of 1954, approximately $1,500,000 of that basis was allocable to the lease (*i.e.*, the right to receive $600,000 per year for 26 more years) and approximately $1,000,000 was allocable to the reversionary interest. (Pet. 14.) Petitioner claims that since its interest in the leased stock will expire at the end of 26 years, it is entitled to deduct a proportionate part of its basis in that asset each year, *i.e.*, that it can take an annual amortization or depreciation deduction of 1/26 of $1,500,000. The court of appeals, reversing the district court, correctly held that petitioner was not entitled to such a deduction.

It is undisputed that capital stock, like land or bonds, is a non-depreciable asset. *Exposition Souvenir Corp.* v. *Commissioner*, 163 F. 2d 283 (C.A. 2). The question presented is whether petitioner can convert a

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property tax. The question was whether the lessor's exemption was personal to it, or whether it followed the property into the hands of the lessees who enjoyed no such charter exemption. This Court held that the exemption ran with the property, and that the lessees were not liable for the tax; the Court's decision is hardly authority for the proposition that the lessor was the beneficial owner of the securities for federal tax purposes.

portion of its basis in a non-depreciable asset into a depreciable asset merely by making a voluntary transfer of a remainder interest in the asset to its stockholders. We submit that a taxpayer cannot create depreciation where none otherwise would exist, merely by gratuitously dividing its interest temporally, giving the remainder away and retaining an interest which diminishes in value solely due to the passage of time.

Petitioner would receive an unwarranted tax advantage if allowed to create deductions in this manner. If petitioner had distributed its full interest in the stock (including the right to receive the annual rental payments), neither petitioner nor its stockholders would have been entitled to a depreciation deduction. Similarly, if petitioner had held the entire interest in the leased stock until expiration of the lease and then distributed the stock, neither petitioner nor its stockholders would have received a depreciation deduction. By taking a course half way between these two, petitioner should not be able to create a deduction.

A closely analogous Code provision strongly supports this line of reasoning. Section 273 provides that where a person divides his ownership in a piece of property into two temporal interests, *i.e.*, a life estate or term of years and remainder, or reversion, and transfers either or both interests by gifts or devise, no deduction shall be allowed the holder of the life estate for shrinkage due to lapse of time. Here petitioner has gratuitously separated its ownership

of stock into an interest for a term of years and a reversion.

In fact, the change in beneficial ownership here is far less significant than in the typical gift or devise situation with which § 273 deals. Before the distribution petitioner's stockholders had full economic and beneficial ownership (through their corporation) of both the leasehold interest in the stock (with 26 years remaining) and the reversionary interest. The only effect of the distribution was to convert their indirect ownership of the reversion into outright ownership; they continued to own the leasehold interest through their corporation. Thus, as to the shareholders, time works no exhaustion of economic interests, but only a shift of those interests from indirect to direct ownership.[3]

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[3] The instant decision does not conflict with *United States* v. *Ludey*, 274 U.S. 295. That case was concerned with depreciation on a physical plant, which, unlike the corporate stock here in question, would wear out because of use over a limited period of years. Nor are the cases cited by petitioner relating to depreciation of wasting assets acquired by inheritance apposite here.

The instant decision is therefore correct, there is no conflict of decisions, and the unique factual situation which gave rise to these novel questions of law makes further review inappropriate.

Respectfully submitted.

THURGOOD MARSHALL,
*Solicitor General.*

RICHARD M. ROBERTS,
*Acting Assistant Attorney General.*

DAVID O. WALTER,
JONATHAN S. COHEN,
*Attorneys.*

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